

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: INTERSTATE POWER AND LIGHT COMPANY	DOCKET NO. RPU-02-7
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**ORDER SETTING TEMPORARY RATES AND
APPROVING CORPORATE UNDERTAKING**

(Issued October 4, 2002)

On July 15, 2002, Interstate Power and Light Company (IPL) filed with the Utilities Board (Board) proposed tariffs, identified as TF-02-424 and TF-02-425. In TF-02-424, IPL is proposing a temporary increase that would produce additional revenue of approximately \$18,640,899. The temporary increase requested by IPL would produce a 6.7 percent across-the-board increase. In TF-02-425, IPL is proposing a permanent annual revenue increase of approximately \$20,070,773, or an overall annual revenue increase of 7.2 percent. The Board docketed the proposed temporary and permanent rate increases as Docket No. RPU-02-7.

On August 14, 2002, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed an objection to the request for temporary rates. IPL filed a response to the objection on August 29, 2002.

Iowa Code § 476.6(13) (2001) controls the manner in which the Board sets temporary rates. That statute provides, in part:

Upon the request of a public utility, the board shall, when required by this subsection, grant the public utility temporary authority to place in effect any or all of the suspended rates, charges, schedules or regulations by filing with the board a bond or other undertaking approved by the board conditioned upon the refund in a manner to be prescribed by the board of any amounts collected in excess of the amounts which would have been collected under rates, charges, schedules or regulations finally approved by the board. In determining the portion of the new or changed rates, charges, schedules or regulations to be placed in effect prior to a final decision, the board shall apply previously established regulatory principles and shall, at a minimum, permit rates and charges which will allow the utility the opportunity to earn a return on common stock equity equal to that which the board held reasonable and just in the most recent rate case involving the same utility or the same type of utility service, provided that if the most recent final decision of the board in an applicable rate case was rendered more than twelve months prior to the day of filing of the request for temporary rates, the board shall in addition consider financial market data that is filed or that is otherwise available to the board and shall adjust the rate of return on common stock equity that was approved in that decision upward or downward as necessary to reflect current conditions.

In Northwestern Bell v. Iowa State Commerce Commission, 359 N.W.2d 491, 496

(Iowa 1984), the Iowa Supreme Court interpreted this statute and stated, in part:

[I]n the 1983 Code the Assembly telescoped the temporary and permanent rate steps into one procedure, evidently to end the prior problem of a utility's placing its new rates in effect in temporary form under bond and then having little motivation to press forward with the permanent rate aspect. The General Assembly has ended the ability of the utility itself to set the temporary rates in the usual situation; the commission sets them and proceeds to the permanent rates. If instead the utility could obtain judicial review of temporary rates and obtain its desired rates from the courts, as in this case, its motivation to seek permanent rates would be dulled and fulfillment of the legislative scheme would be hampered. To minimize the possibility of harm to the utilities, the

legislature started time running from the original filing as to both temporary and permanent rates . . .

While permanent rates may ultimately be set higher than the commission's temporary rates, by shortening the time for the commission's final decision to ten months and by streamlining the temporary and permanent rate procedure, the Assembly has demonstrated its desire to minimize utility hardship.

The Board, therefore, is directed to permit IPL to collect rates which, at a minimum, allow the return on common equity equal to that which was held reasonable in the most recent rate case involving the same utility or same type of utility service, provided the Board's decision was rendered within 12 months prior to IPL's request for temporary rates. If there is not a Board decision within the prior 12 months, the Board shall consider market data that is filed or that is otherwise available to adjust the most recent return on common equity to reflect current conditions.

In addition, the Board is directed to apply established regulatory principles in setting the return on common equity and considering any proposed adjustments. Since the legislature directs the Board to establish a temporary rate level by applying established regulatory principles rather than examining an evidentiary record, it is not appropriate for the Board to make detailed findings of fact on each individual issue.

Consumer Advocate's objection to IPL's request for temporary rates and IPL's response to the objection narrowed the issues to be considered in setting temporary rates. The issues to be addressed will be discussed below:

COST OF CAPITAL

A. Return on Common Equity

In determining the appropriate return on common equity to use in setting temporary rates for IPL, the Board must apply the requirements of Iowa Code § 476.6(13) set out above. The last fully litigated general gas rate case involving IPL or one of its predecessors, IES Utilities Inc. and Interstate Power Company, was decided in 1996. There have been more recent decisions but those were settled cases and the Board has held that it is inappropriate to use a return on common equity from a settled case to set temporary rates. Interstate Power Company, Docket No. RPU-95-1, "Order Setting Temporary Rates and Approving Corporate Undertaking" (June 29, 1995).

Since IPL has not had a general rate case decision within the last 12 months, it proposed to use the 12.10 percent return on common equity for temporary rates that it proposed for final rates. IPL witness Frank Hanley developed the 12.10 return on common equity based upon four market-based return models. Witness Hanley suggests that under the Efficient Markets Hypothesis, investors are aware of multiple market-based models, and use of the four market-based models is necessary to determine an appropriate return on common equity for IPL.

Consumer Advocate proposes a return on common equity of 10.81 percent. This return on common equity is calculated using an A-rated public utility bond yield average of 7.31 from July 2002. Consumer Advocate then adds a 250 to 450 basis point risk premium range to produce a return of equity range of 9.81 percent to

11.81 percent. Consumer Advocate supports the midpoint of the range, which is 10.81 percent.

The Board has used a risk premium methodology in recent decisions to establish a return on common equity for temporary rates. In the two most recent Board decisions concerning temporary rates for MidAmerican Energy Company, Docket No. RPU-02-2, and Aquila, Inc., d/b/a Aquila Networks, Docket No. RPU-02-5, this methodology was used. The Board finds that this is the established regulatory principle to utilize in this case. This methodology has consisted of adding a risk premium range to the most recent market yield for A-rated utility bonds and then adopting a point in the range based upon current economic factors. Although different risk premium ranges have been approved by the Board, the Board has recently used a risk premium range of 250-450 basis points. The Board finds that this range should be used in setting temporary rates for IPL.

The most current A-rated utility bond yield available to the Board is 7.31 percent for July 2002, found in the "Mergent Bond Record," August 2002. Using the Board's usual risk premium range of 250-450 basis points yields a range of reasonable returns from 9.81 to 11.81 percent.

The Board found a return on common equity of 11.3 percent was reasonable for MidAmerican and Aquila using an April 2002 bond yield of 7.57 percent and a May 2002 bond yield of 7.52 percent respectively. The Board did not view the downward movement of bond yields to be significant enough in the Aquila case to require a downward adjustment from the 11.3 found reasonable for MidAmerican.

The most current bond yield from July 2002 though shows a significant movement downward from the levels in April and May 2002 and the Board finds that some adjustment is required of the return on common equity to reflect this movement. Recognizing that a downward movement in bond yields may increase risk premiums, the Board finds that in this instance the return on equity for temporary rates for IPL should approximately reflect the 26 basis points between the 7.57 percent bond yield used to calculate the return on common equity for MidAmerican and the 7.31 percent from July 2002.

Based upon the movement in the bond yield discussed above, the Board finds that the return on common equity to be used in calculating temporary rates for IPL is 11.05 percent. This return reflects the current economic conditions.

B. Double Leverage

IPL did not account for double leverage in its calculation of its overall weighted average cost of capital. IPL contends that double leveraging does not impact the capital structure of IPL since the only outstanding debt for IPL's parent, Alliant Energy Corporation, was issued by WPL Holdings, Inc., prior to the merger and was used to fund investments made by subsidiary of WPL Holdings, Inc. The proceeds could not have been used by IPL or its predecessors.

Consumer Advocate argues that the Board has recognized the use of the debt by the parent company in a regulated company's capital structure. Consumer Advocate argues that the existence of double leverage in the capitalization of IPL must be recognized in the calculation of the temporary revenue requirement.

The Board finds that the use of double leverage is the regulatory principle that should be followed. The use of double leverage has a minimal effect on temporary rates in this case. Whether the debt of the parent company, Alliant Energy Corporation, should be used in establishing permanent rates is an issue that can be addressed in the permanent rate proceeding.

II. RATE BASE

A. Year End Plant

IPL made adjustments to its actual 13-month average rate base to include year-end rate base. IPL acknowledges that under established regulatory principles, the rate base is based on original cost and the average 13-month ending account balances. Consumer Advocate supports the average 13-month ending account balances for determining rate base for temporary rates.

IPL contends that Consumer Advocate's position is unreasonable since Consumer Advocate accepts the year-end customer revenue adjustment without accepting the year-end plant additions and depreciation adjustments. IPL points out that the Board approved similar adjustments in determining temporary rates for MidAmerican in Docket No. RPU-02-2.

The Board found in Docket No. RPU-02-2 that the rate base and expense adjustments were reasonable since they matched known and measurable changes in rate base to known and measurable changes in revenue associated with sales growth. The Board finds that the adjustments made by IPL are similar and should be

treated in the same manner. The Board will approve IPL's proposed rate base adjustments.

B. Cash Working Capital

IPL used a revenue collection lag of 27.1 days, resulting in a total revenue lag of 45 days, based upon a lead-lag study using 2001 data. IPL states that the 2001 lead-lag study should be applied to temporary rates just as it was for temporary rates in IPL's electric rate increase application, Docket No. RPU-02-3. IPL argues that its position is supported by Board rule 199 IAC 7.4(6)"e"(5), which requires a lead-lag study that, "accurately represents conditions during the test period."

Consumer Advocate proposes the Board use a 21.8-day revenue collection lag, which would result in a total revenue lag of 39.7 days in the lead-lag study used for calculating temporary rates.

The Board finds that the 2001 lead-lag study is appropriate for determining temporary rates for IPL. This is the lead-lag study adopted by the Board in IPL's electric rate application for temporary rates. The 1999 and 2000 studies should be filed as part of the permanent rate case proceeding for Board consideration.

In addition, the Board will make corrections to IPL's working capital work sheet to include the tax effects of the pro-forma adjustments.

III. INCOME STATEMENT

A. Other Post-Employment Benefits (OPEBs)

IPL proposes an adjustment to allow recovery for increases in post-employment benefit (OPEB) costs, excluding pensions, calculated pursuant to FAS

106. This increases OPEB expenses nearly 60 percent in 2002 over 2001. The 2002 costs are booked by IPL based upon actuarial data prepared by Towers Perrin.

Consumer Advocate proposes that no adjustment be made for OPEB expenses or that an adjustment be based upon the average OPEB expense for the period 1999 through 2001. Consumer Advocate's proposal is based upon three factors. First, IPL's OPEB costs have fluctuated significantly over the past three years and therefore 2002 costs are not representative. Second, IPL has some control over the level of OPEB expenses and so the Towers Perrin data is not completely independent. Third, the Board has not found the 2002 expenses to be reasonable.

The Board finds that the amount of OPEB costs booked by IPL for 2002 are the appropriate level to use in calculating temporary rates. IPL books OPEB expenses based upon the Towers Perrin data and those expenses are appropriate for calculating temporary rates. Consumer Advocate has raised several issues that suggest the Towers Perrin data is not representative of ongoing OPEB expenses and those issues can be addressed in the proceeding concerning permanent rates.

B. Pensions

Consumer Advocate objected to the inclusion by IPL of an adjustment to pension expense reflecting cash contributions to the pension fund in 2002.

Consumer Advocate pointed out that the last Board decision on pension expense approved pension expense based on accrual accounting under FAS 87. Consumer

Advocate proposed that no adjustment be made or that the Board adopt a three-year average using 1999-2001.

IPL agreed with Consumer Advocate that Board precedent precluded the use of cash contributions to the pension fund for calculating temporary rates. IPL then proposed to use the 2002 FAS 87 pension accrual as determined by Towers Perrin.

The Board finds that the 2002 FAS 87 pension accrual is appropriate for calculating temporary rates for IPL. The most recent Board precedent supports use of this amount.

C. Former Manufactured Gas Plant Site Remediation

IPL proposes to increase the clean-up expense for former manufactured gas plant (FMGP) sites. IPL states that the proposed temporary amount is based upon anticipated activity level and clean-up costs and IPL is required by the Iowa Department of Natural Resources and federal Environmental Protection Agency to investigate and remediate these sites.

Consumer Advocate argues that the increase in expenses associated with FMGP clean up is not known and measurable and therefore should not be used in calculating temporary rates. Only a representative amount of FMGP costs should be included.

The Board finds that the increase in FMGP site remediation expense proposed by IPL is not known and measurable and therefore will not be included in calculating temporary rates. The costs proposed by IPL are forecasts and whether

they should be included in permanent rates is an issue for the permanent rate proceeding.

D. Year-End Depreciation

IPL proposes to increase depreciation expense based upon year-end plant balances. This adjustment matches IPL's proposed year-end rate base adjustment discussed in section II.A above. Consumer Advocate objects to this adjustment on the same basis as the year-end rate base adjustment.

As stated by the Board in section II.A above, inclusion of year-end rate base and related year-end depreciation expense is consistent with inclusion of year-end revenue levels based upon sales growth.

IV. RATE DESIGN

A. Temporary Rate Design

IPL has agreed to accept a temporary rate design based upon the Board's decision on temporary rates for MidAmerican in Docket No. RPU-02-2. The Board will adopt the same temporary rate design. This method generally applies three criteria for designing temporary rates.

1. Rate codes with proposed final rate reductions receive no temporary increases;
2. No rate code receives a temporary increase larger than the increase proposed for final rates; and
3. The temporary increases are otherwise applied on a uniform percentage basis to monthly non-gas cost/non-EECR rate elements.

The Board recognizes that the application of the first two criteria may mean that some rates will not comply with the third criteria. The Board finds this is acceptable and unavoidable due to the interrelationships between full service and transportation rate codes and rate structures. Under the temporary rate design approved by the Board, some rate codes may receive more than the uniform increase.

For example, to ensure that transportation service rate codes do not exceed the proposed final increase limits, it may be necessary to make no changes to monthly transportation administrative charges and nominating fees. Schedule E attached to this order shows the estimated non-gas/non-EECR increases by tariff rate code. The percentage calculations reflect subtraction of revenues and billing determinants associated with the discount volumes shown in IPL's workpapers.

B. Reconnect and Posting Charges

IPL proposes an increase of 68 percent for its reconnection charge and a new \$26 charge for posting customer premises in its permanent rate request. IPL included these charges in its work papers for the temporary rate request. Consumer Advocate did not address these proposed increases.

The Board will not include the proposed increases in its calculation of temporary rates. These types of increases are historically considered in permanent rate proceedings and not temporary rate proceedings.

V. CORPORATE UNDERTAKING

In conjunction with the application for temporary rates, IPL filed a corporate undertaking in which it agreed to refund any temporary rates up to \$18,640,899, with interest, which are collected that exceed final rates ultimately approved by the Board. The Board finds that this corporate undertaking is sufficient to ensure payment of any required refund and it will be approved.

VI. ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. Temporary rates based on this order shall become effective as of the date of this order, pursuant to Iowa Code § 476.6(13) (2001).
2. On or before 20 days from the date of this order, Interstate Power and Light Company shall file revised tariff sheets that produce total revenue, including a temporary rate increase of \$16,909,274 not to exceed \$268,961,398. Attached to

this order, and incorporated by reference, are Schedules A through E reflecting total revenue requirement, rate base, weighted cost of capital, income statement, and estimated percentage increases for temporary rates.

3. Interstate Power and Light Company's corporate undertaking is approved.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 4th day of October, 2002.

Interstate Power and Light Company
Revenue Requirement
Docket No. RPU-02-7
Temporary Rates

Schedule A

Line No.	Item	Amount (A)
1	Rate Base	\$178,492,301
2	Rate of Return	9.031%
3	Required Return	<u>\$16,119,640</u>
4	Less: Adjusted Operating Income	<u>\$6,239,551</u>
5	Net Operating Income Deficiency	\$9,880,089
6	Income Tax Effect	<u>\$7,029,185</u>
7	Revenue Deficiency/(Excess)	\$16,909,274
8	Plus: Adjusted Test Year Revenues	<u>\$252,052,124</u>
9	Revenue Requirement	<u><u>\$268,961,398</u></u>

Interstate Power and Light Company
Adjusted Rate Base
Docket No. RPU-02-7
Temporary Rates

Schedule B

Line No.	Description	Adjusted Amounts
		(A)
1	Utility Plant in Service	\$307,286,933
2	Accum. Depr. & Amort.	(\$121,825,649)
3	Net Plant	<u>\$185,461,284</u>
Additions:		
4	Materials and supplies	\$1,153,574
5	Fuel Stocks	\$173,141
6	Prepayments	\$14,036,081
7	Cash working capital	(\$130,384)
Deductions:		
8	Accumulated deferred income taxes	(\$18,719,327)
9	Customer advances	(\$399,939)
10	Customer deposits	(\$839,541)
11	Unclaimed property	(\$7,207)
12	Accu. prov. for uncollectibles	(\$483,068)
13	Accrued liability account	(\$1,051,275)
14	Accrued vacation	(\$212,277)
15	Accrued pension plan obligations	<u>(\$488,761)</u>
16	Total Rate base	<u><u>\$178,492,301</u></u>

Interstate Power and Light Company
Rate of Return
Docket No. RPU-02-7
Temporary Rates

Schedule C

Alliant Energy Corporation
Weighted Average Cost of Capital

Line No.	Description	Amount (A)	Ratio (B)	Cost Rate (C)	Weighted Cost (D)
1	Long-Term Debt	\$24,000,000	1.327%	8.590%	0.114%
2	Preferred Stock	\$0	0.000%	0.000%	0.000%
3	Common Stock	\$ 1,784,023,634	98.673%	11.050%	10.903%
4	Total	<u>\$ 1,808,023,634</u>	<u>100.000%</u>		<u>11.017%</u>

Interstate Power and Light Company
Weighted Average Cost of Capital

Line No.	Description	Amount (A)	Ratio (B)	Cost Rate (C)	Weighted Cost (D)
5	Long-Term Debt	\$ 812,853,770	48.567%	7.294%	3.542%
6	Preferred Stock	\$ 60,178,519	3.596%	6.086%	0.219%
7	Common Stock	\$ 800,653,127	47.838%	11.017%	5.270%
8	Total	<u>\$ 1,673,685,416</u>	<u>100.000%</u>		<u>9.031%</u>

Interstate Power and Light Company
Adjusted Income Statement
Docket No. RPU-02-7
Temporary Rates

Schedule D

Line No.	Description	Adjusted Amounts (A)
1	Operating Revenues	<u>\$268,961,398</u>
2	Operating Expenses:	
3	Gas Purchased for Resale	\$191,867,179
4	Operations Expenses	\$33,388,781
5	Maintenance Expenses	\$3,547,429
6	Depreciation and Amortization	\$11,656,554
7	Other Taxes	\$1,083,293
8	Income Tax:	
9	Current Federal	\$5,253,397
10	Current State	\$1,642,024
11	Deferred	\$496,395
12	Investment Tax Credits	<u>(\$244,314)</u>
13	Total Operating Expenses	<u>\$252,841,759</u>
14	Net Operating Income	<u><u>\$16,119,640</u></u>

SCHEDULE E

Estimated Temporary IPL Non-Gas/Non-EECR Rate Increases by Tariff Rate Code (RPU-02-7)

	<u>Tariff Sheet References</u>	<u>IPL Proposed Final Non- Gas Rate Changes</u>	<u>Estimated Temporary IPL Non-Gas Increases</u>
<u>IES NORTH</u>			
Residential	40	37.0%	33.8%
General Service	41-42	25.5%	25.5%
Optional General Service	43-44	57.6%	33.8%
Large Optional Gen. Serv.	45	Deleted	33.8%
<u>IES SOUTH</u>			
Small Volume Firm	58	64.0%	33.8%
Medium Volume Firm	59	11.6%	11.5%
<u>IES NORTH & SOUTH</u>			
Large General Service	46-47	16.6%	16.5%
Small Transportation	48-57	20.8%	20.7%
Large Transportation	48-57	7.7%	7.7%
Pipeline Corridor Trans.	60	228.8%	33.8%
<u>IPC MASON CITY</u>			
Residential and General Service	100	26.6%	26.5%
Contract Quantity Firm	101	52.8%	33.8%
Interruptible	103	(41.3%)	—
Small Transportation	105,136,140	8.7%	8.7%
Contract Quantity Firm Trans.	105,136,140	64.0%	33.9%
Interruptible Transportation	107,136,140	7.3%	7.2%
Pipeline Corridor Trans.	130,136,140	(67.1%)	—
<u>IPC CLINTON</u>			
Residential and General Service	109	18.3%	18.3%
Contract Quantity Firm	110	15.4%	15.4%
Interruptible	114	31.8%	31.8%
Large Contract Demand	112	53.9%	33.8%
Small Transportation	116,136,140	1.9%	1.8%
Contract Quantity Firm Trans.	116,136,140	5.8%	5.6%
Interruptible Transportation	120,136,140	90.3%	33.8%
Large Contract Dem. Trans.	118,136,140	45.5%	32.7%
Pipeline Corridor Trans.	130,136,140	(46.2%)	—